

RICHARD RUSSELL'S DOW THEORY LETTERS, INC.

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LETTER 792

Sept. 12, DJIA 936.52; PTI 1309; A-D Ratio -16.06
Sept. 19, DJIA 963.74; PTI 1323*; A-D Ratio -15.33*

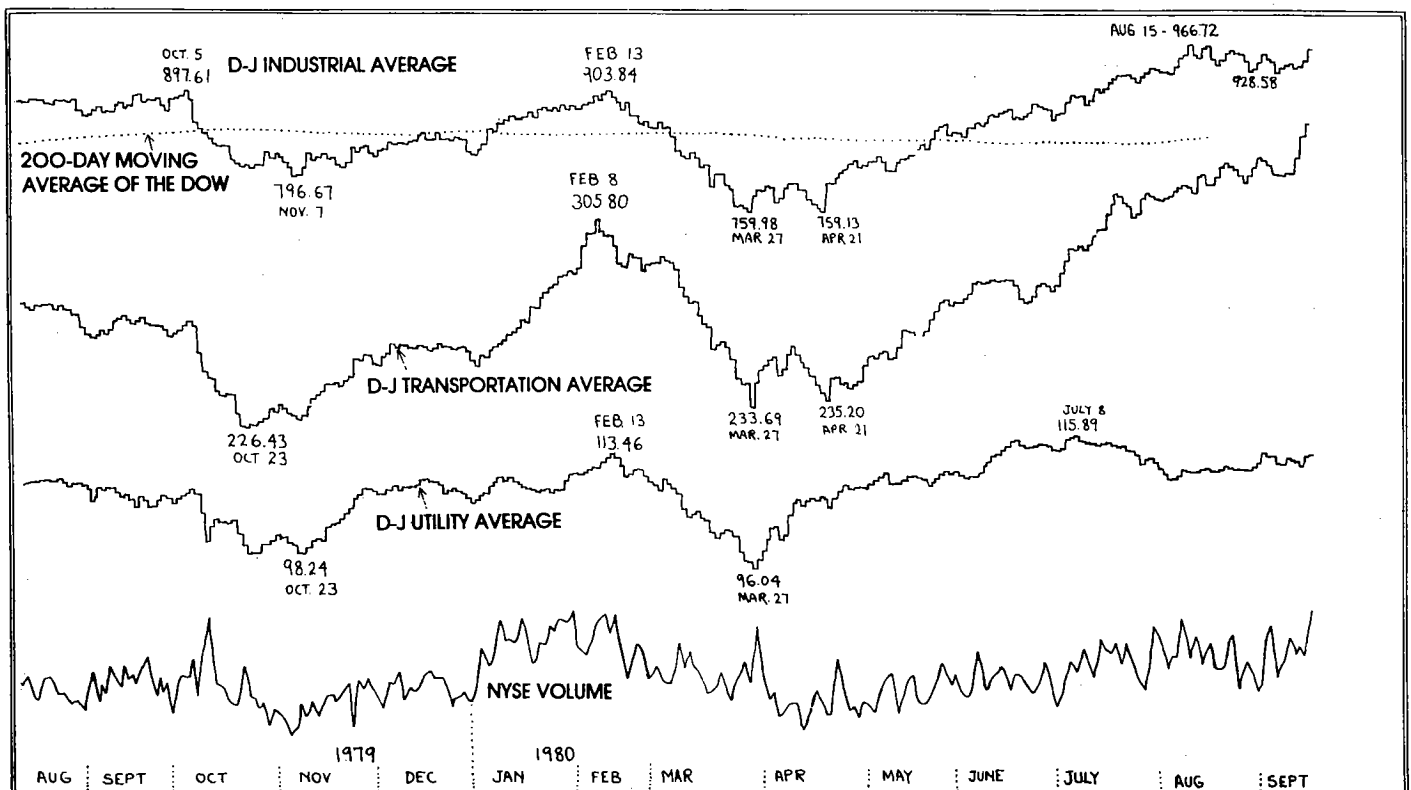
THE PICTURE: I believe I follow most of the major stock market services now being published. And to tell the truth, I have been a bit taken aback by the almost unanimous opinion that the market "is heading into a correction." Now let's not be arrogant about the situation. The fact is that a number of items have suggested an oncoming correction. From the standpoint of the extent and duration of this rise, the upside non-confirmation in the Averages, the lagging advance-decline ratio, the members' trading statistics, the overbought condition of stocks (i.e., stocks holding above their moving averages) a correction appeared warranted. Anyone who had ever studied markets had to be somewhat queasy about the technical picture (Joe Granville excepted).

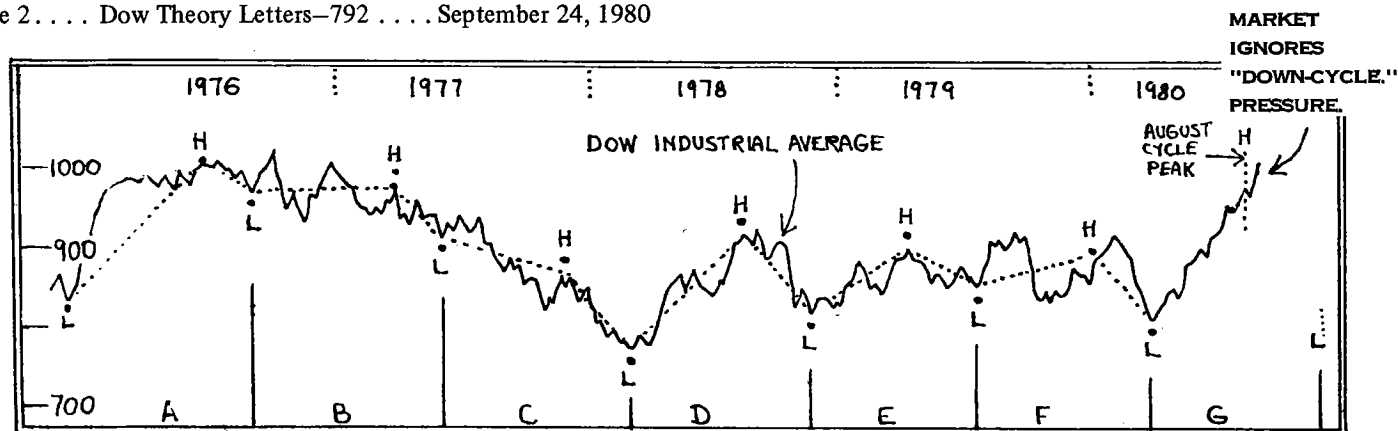
Of course there was another fellow who has continued to say "up." That fellow is my Primary Trend Index (PTI). This extraordinary index has been steadfast in saying "higher" and as subscribers know, I've learned not to argue with the PTI. I let it tell its story, and I simply make damned sure that I stay on the right side of the PTI.

In July the Industrials and Transports bettered their preceding February peaks, and according to Dow's classic Theory, a bull market was proclaimed. Since then, the direction of the market (with a few minor pauses) has been up. On September 28 (see chart below) the Industrials dropped to a low of 928.58, but as you can see Transports didn't begin to confirm. A few days later Transports surged to an historic high with Industrials moving bullishly in the same direction. There's no question about it—this market is strong.

FRONT PAGE COMMENT: Many analysts are talking about a decline in inflation. I don't see it, and neither do the money markets. Government spending has been rising at an annual rate of 15% over the past few quarters. President Carter has approved a 9.1% pay boost for 1.4 million federal employees, an increase of 30% over last year's pay boost. Social Security taxes will rise \$18 billion next year, and the effect of all this will probably be washed out via additional inflation. The cost of servicing the Federal debt will rise to near \$75 billion this year, much more next year. In order to cover these booming expenses, the money supply (and, the deficits) will have to be expanded anew. As I've said many times, the US has placed itself in a position where it must "inflate or die" (and our politicians are not ready to lay down and die just yet). The fact is that the need for inflation (to cover the rising deficits) is so strong that "not enough inflation" will immediately place the US economy in a deflationary position. So, not only do we have to inflate, but we have to inflate at an INCREASING rate.

All right, on to the next subject. I've been pondering the market picture long and hard. And from the standpoing of my own studies, I'd say that there are four major technical considerations at this time. The first deals with the shorter-term picture, and here I turn to my 233-day market cycle (see page 2 chart). Perhaps it was coincidence, perhaps not, but the Dow hit a peak of 966.72 on August 15, exactly at the top of the 233-day cycle. From mid-August to late-October, the market will be operating *within the bear segment* of the cycle. At the end of October, the 233-day cycle will turn bullish again. How the market does





between August 15 and late-October will tell us a lot about its inherent strength. So far, the word is "strong."

As I've said, the market is already better than one month past the bull peak of the 233-day cycle, and aside from a few weeks of backing and filling and hesitancy following August 15, there has been *little or no give*. Which brings me to the second technical consideration. The Primary Trend Index (PTI), which is my proprietary index of market strength or weakness, has been hitting high after high. This action tells us that regardless of fluctuations in the Averages or in any other indicators, the market is retaining its remarkable strength (this may start to change between now and the next report, but I can only write about what I see NOW).

The third technical consideration is illustrated in the page 3 point & figure chart of the Standard & Poor's 500 Stock Composite. I included this chart in Letter 788 along with my interpreta-

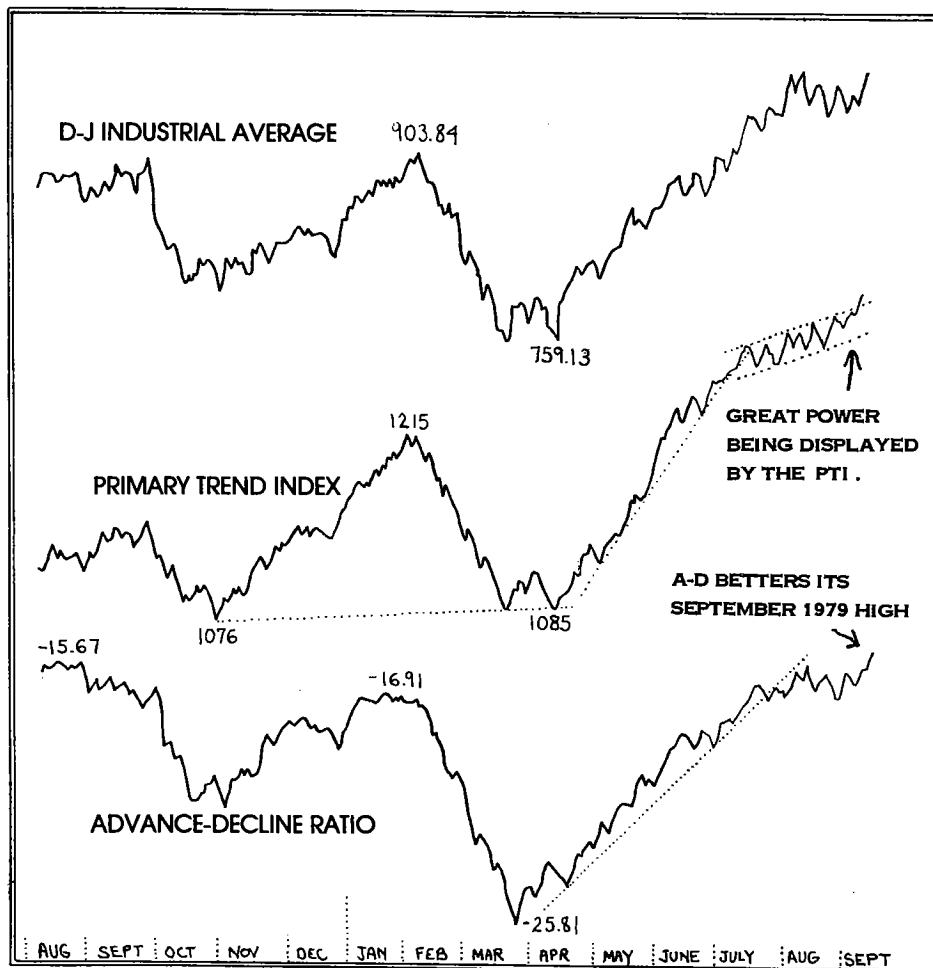
tion, and I'll comment on this chart again now. From a strict technical standpoint, the chart presents the picture of a massive base of accumulation. I have drawn line "A" to indicate the upside resistance, a resistance line which extends horizontally from the 1973 top. This month the S&P 500 pushed above line A, and thus the bullish pattern is rendered operative. The base shown here is large enough to send the S&P 500 up into the stratosphere. And it is perhaps the strength of this base that has militated against the "normal" corrective tendency of the market at this time.

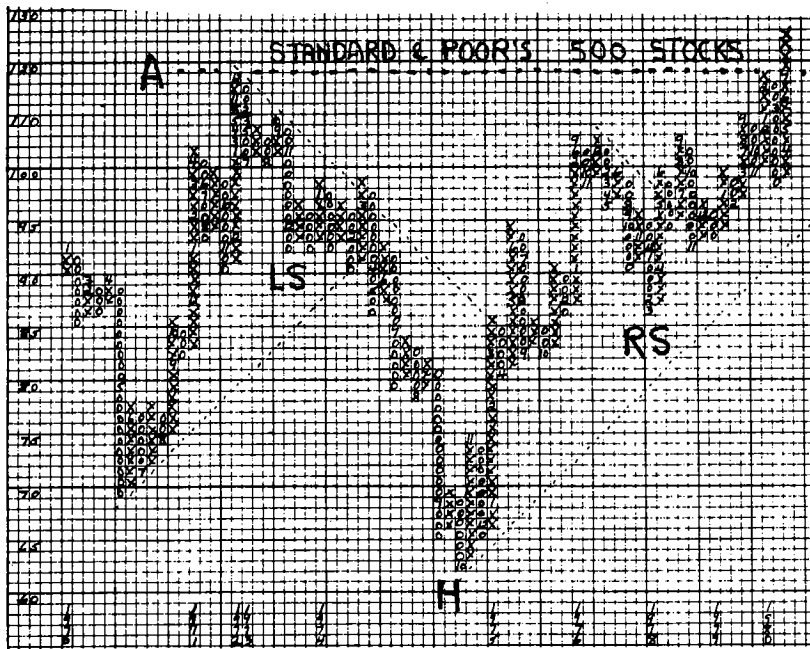
"Wait a moment," you retort, "What in the name of heaven could prove bullish enough to send this chart out into space?" And I must answer that I don't know—or that it could be any of a hundred different phenomena. For instance, we could see a collapse of the Russian empire, we could develop a totally new source of energy, we could witness an onslaught of hyperinflation with an accompanying flight from paper. Or who knows—we could even have a period of international peace and equanimity. The fact is that I have no business trying to explain this huge base in the S&P 500 Composite. I'm simply drawing subscribers' attentions to it—it's there, and we cannot ignore it.

The fourth technical consideration is of long-term importance. Over the past few years I have continuously drawn attention to a chart of the Dow Industrials, a chart which shows a formation which I have termed "The Great Circle." I include this chart again in this report (at bottom of page 3).

This chart of the Dow (monthly) going back decades traces a phenomenon which I will describe as follows: In the course of the great 1929-32 crash, the Dow hit a final low of 41.22 (July, 1932). The Dow then pushed steadily higher, and as you can see on this chart, each successive major bottom in the Dow was higher than the preceding bottom. This series of higher bottoms continued for over 30 years.

Beginning in 1963 the Dow moved into the remarkable Great Circle pattern. Note that the long rising curve under the Dow was broken in 1966 (this occurred within the Great Circle). In 1970, for the first time since 1932, a Dow low smashed below the previous major Dow low. This was followed by a new record high in 1973 (still within the circle), and then a drastic new low in





1974 (a low which nevertheless held within the circle). In 1976 the Dow pushed to the top limit of the circle, then broke to a 1978 low of 759.

Last year I stated that the year 1980 would be marked by one very important event: up or down, the Dow would push OUTSIDE THE CIRCLE for the first time since 1963. The question that is immediately asked is, "What does this mean?"

I will try to interpret the action on a strict technical basis. As I see it, the entire Great Circle pattern can be viewed as a massive 17-year consolidation pattern. During this period, the Dow was whipped up and down by every conceivable news event and economic development. Technically, this 17-year consolidation might be seen as a reaction to the phenomenal 4200% rise from the 1932 Dow low of 41.22 to the 1966 peak of 995.15. But one way or another, the Dow was unable to make any net progress during the period of 1963 to 1980.

Now in a violent rally, backed by the largest short interest in NYSE history, the Dow is pushing authoritatively out of the circle—and UP. What could this mean? I won't go into the philosophical or economic meaning of the move, but it does seem to be that something NEW is occurring. I don't know whether this new phenomenon is good or bad for the country. I do think, however, that there is a good chance that the Dow will head for the old highs (1050 area). If the Dow can better the old high I believe it will have to go to 1100 before most people believe that "something has changed." Remember, the Dow has been trying for two decades to push beyond the 1000 area—it has never succeeded.

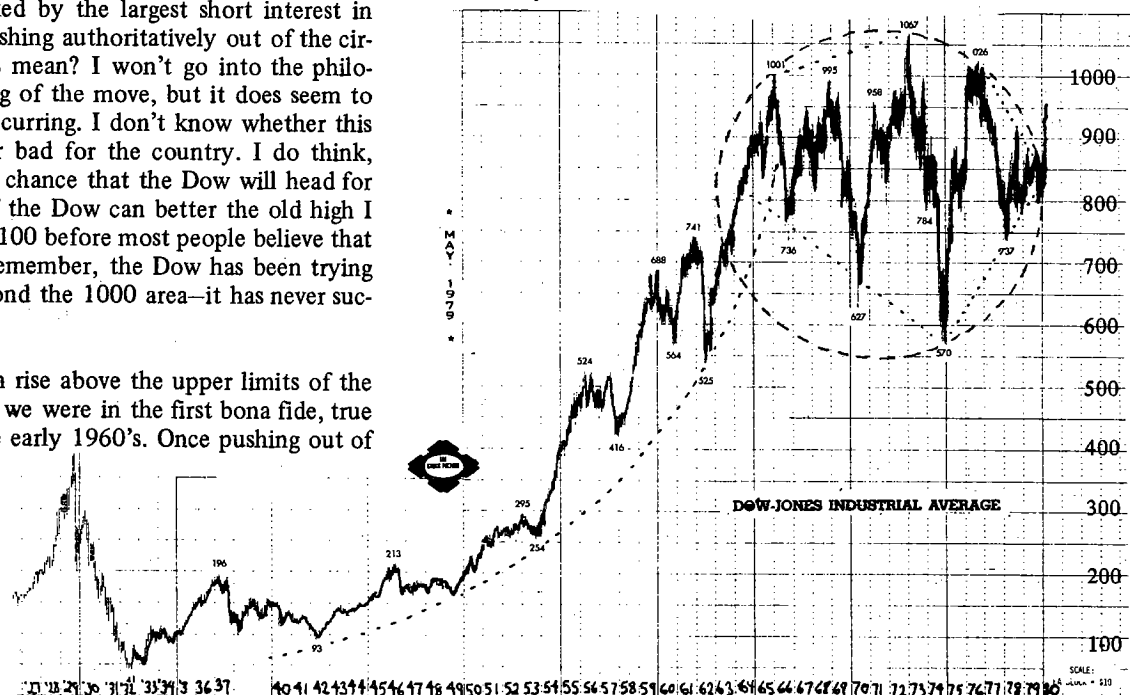
If, and I say IF, the Dow can rise above the upper limits of the great circle, then I'd say that we were in the first bona fide, true primary bull market since the early 1960's. Once pushing out of

the top of the Great Circle we ask, "how high could this market go?" Obviously, no one knows, but I would guess that the impetus could carry the Dow to or around 2000.

In the meantime, there is the question of strategy and tactics. How much stock should you own? No one can tell you what your sleeping point is. Some men (and women) are "big shooters," they love to be 100% invested. Others are "accumulators," they like to have some stocks, some gold, some T-bills, a house, a portion of this or that. Some are just plain cautious, and they will want to own 30% to say 50% in stocks. I can't make decisions for each one of you, but I can tell you that the upside potential for this market is there. Stocks, like gold and precious metals and collectives and real estate, are becoming a legitimate item in the world-wide flight from paper!

Conclusion: This has to be considered an extraordinary conclusion, but here it is. The PTI is climbing, climbing, and I haven't seen it this strong since 1974-76. The chart of the S & P 500 suggests that the market has just broken out of a huge base. The Great Circle chart indicates that something almost unprecedented is occurring. The Dow is not even above the upper ridge of the Great Circle yet. My own feeling is that investors should now be buying "the market" rather than trying to pick individual winners. The best and cheapest way to do this is via the no-load stock funds, and very preferably funds with "switch privileges." I list a few funds which I like as follows: *Dreyfuss Number Nine* (767 Fifth Ave., NYC 10022; 800-223-5525). *New Era Fund* (100 E. Pratt St., Baltimore, MD 21202; 800-638-1527). *Explorer Fund* (Box 1100, Valley Forge, PA 19482; 800-523-7910). *Partners Fund* (522 Fifth Ave., NYC 10036; 212-790-9800).

"Why not pick the individual winners?" you ask. My answer is that in a bull move, sooner or later almost everything is a winner. And it's easier, safer and better for your nerves to buy the market and let the pro's put together your portfolio. I find that given a bull trend, most pro's will do well. It's during the periods such as 1973-74 that the pro's are destroyed. But that's not our problem today.



PHILOSOPHY: Some advisors are adamant and mechanical about investment strategy. They state that you must be "100 long when the trend is up, and out or preferably short when the trend is down." I don't agree. I don't agree because more money is probably lost through fear or inability to hold one's position than is lost on being on the wrong side of the market trend.

Take a cautious investor with limited capital. Put him 100% long during a bull market. Then comes the first reaction, and this man cannot sleep, he cannot think clearly, he cannot eat his meals, he can't function. "Is anything worth this worrying?" he asks himself. Finally, in a frenzy (his portfolio is now down 7%) he calls his broker and fairly shouts, "Sell me out!" He's thrown for his first loss in the bull market.

This man should have had perhaps 15% to 20% of his capital in stocks. With that kind of position, he could tell himself, "Look, if the market does go down 20% I'm only out 4-5% on my capital. That doesn't bother me." He sits, and the reaction bottoms out, and the market turns up. A year later the bull trend has given him an overall profit of 50% on his stock portfolio. He didn't "clean up," but he did make money. And he didn't lose sleep. And he gained confidence, and he had the satisfaction of knowing that he was right.

I have found that one of the hardest things to do in investing is sit it out, to ride out the primary trend. Very, very few investors ever make the big money, because they either sell out too soon or ride over the top. If you sell out too soon it's usually because you have too big a position, and you can't resist that first fat profit. "After all," you tell yourself, "I don't want to be a pig. I've made 80% on my investment, and that's good enough for me." A year later your original investment is up 200%, and you're mumbling to yourself, "Why did this happen?" You had too large a vested interest in that huge position, you couldn't take the heat, and you grabbed your profit instead of letting the primary trend do its work for you.

Conclusion: Know your temperament, know how much heat and pressure you can take. Let the market tell you when to get out, rather than your fear or the pressure of a position that is too big. I've said this before, and I'll repeat it: No profit or potential profit is worth the loss of night after night of sleep and possible damage to your health. Investments are supposed to help you, rather than take years off your life! No single, mechanical investment formula or strategy works for everyone. Each man and woman is different, each psyche is different, each must make money his own way.

NOTES & QUOTES: You Only Live Twice Dept: My oldest daughter (I have 3) is 24. My youngest child is Ryan Russell, now 2½. There's one more addition, and that's it. By the miracle of amniocentesis, we now know (assuming the doc read the chromosomes correctly) that it will be a girl, slated to burst forth on the world around Christmas, 1980. The name will be Lauren Lee Russell. There, my participation in the US population explosion is over!

Statistic of the week: There are 12,000 men and women in the US over 100 years of age. Now that's a select club!

Here are a few other interesting statistics. Saudi Arabia is the size of the US east of the Mississippi. Yet only 1% of this land is inhabited. And in all this vast area, there is not a single body of fresh water. Gasoline in Saudi Arabia is 31cents a gallon. Bottled water is \$5 a gallon.

Few have noticed, but the negative yield curve is back. Near-term Treasury notes now yield around 11.7% while the long-terms yield 11.3 to 11.5%. That's money pressure starting again. In recognition of which, the big NYC banks on Sept. 19 raised the prime rate to 12.5%.

Treasury Market Yield Curve Resumes Its Negative Slope

After briefly achieving a normal positive slope, the Treasury coupon yield curve turned negative again last week as short rates rose much more sharply than long rates in a reversal of the prior week's trend.

Coupon issues dropped 7/8 to . . .

Question: How is it that Abbie Hoffman could hide out from the FBI, the police and all manner of law enforcement agencies for over three years? Answer: He was a salesman for Chrysler.

A month or so ago the press suggested that the Soviet "was bogged down in Afghanistan" and indeed it was hinted that Afghanistan was Russia's Vietnam. My answer was, "Forget it, the Soviets will wipe out the Afghans to a man if they have to. The Russians are ruthless and will do what they have to—to win." Here's a late news clip that indicates (1) Afghanistan is no Russian Vietnam, (2) the Russians are pitiless, (3) the Russians are using the war as a try-out stage for new weapons.

Soviets Using New Rifles In Afghanistan

NEW DELHI — Soviet soldiers in Afghanistan are using a new assault rifle that causes wounds similar to those resulting from soft-nosed or dum dum bullets that are outlawed by international convention, according to diplomats.

Some of the 85,000 Soviet troops in Afghanistan are being issued the new AK-S rifle, which is described by the diplomats as a new version of the AK-47, the standard Soviet field weapon. They said the effect of impact of bullets fired from this weapon is similar to the so-called dum

dum bullets that are constructed to burst on impact causing gaping wounds and massive blood loss. The diplomats said another weapon recently employed by the Soviets in Afghanistan is a cluster bomb filled with thousands of needle-sharp arrows. The anti-personnel device scatters the needles over a wide area, wounding people and animals indiscriminately.

The introduction of these devices to complement the helicopter gunships, tanks, half tracks and highly mobile artillery, already massively deployed, has come amid what the diplomats here viewed as signs of further deterioration in the Afghan army and greater involvement of the Soviets.

— New York Times

Britain's Margaret Thatcher's popularity has dropped to its lowest level yet. Why? Britain's unemployment is up and the squeeze is becoming painful. To my mind, this is ominous. It is telling me that Britain will not accept the pain which is necessary if the rate of inflation is to be reduced. And if they won't do it in Britain, they won't do it here.

Fascinating words from the Sept. 17 Eliot Janeway (Janeway Letter, 15 E. 80 St., NYC 10021). "Is Wall St. onto the hyper-inflationary storm? They don't have a clue yet. . . . Wall St. will discover the business boom as an arms boom; it's not scheduled to do so until October—after the spending explosion has agitated the money stream and driven interest rates significantly higher. The resurgent gold move is expressing the dismayed suspicion dawning on the markets that Reagan does not offer a responsible alternative to Carter—he's irretrievably committed to out-inflate Carter."

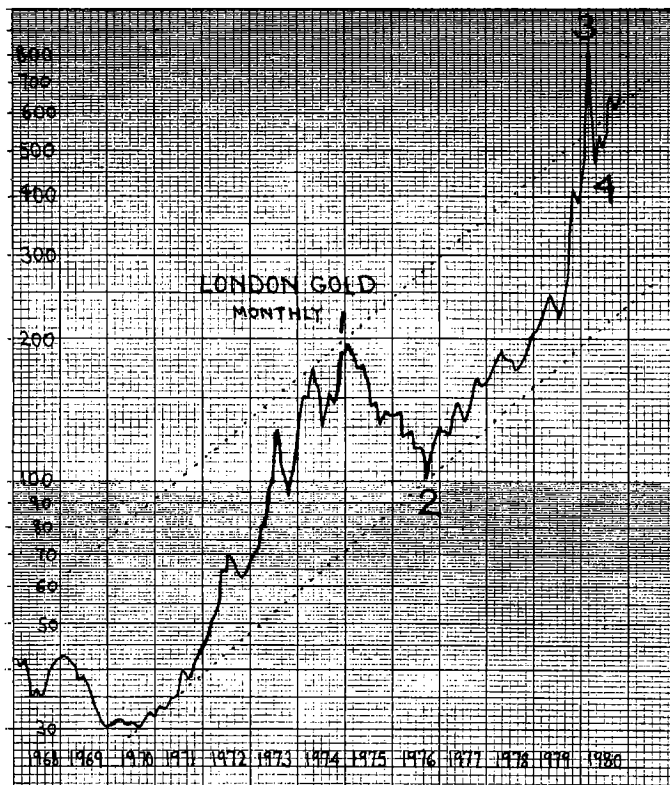
I guess you could call this cartoon a comment on the morality of the 1980's.



And I guess you could call this item a comment on the financial morality of the 1980's. Poland's debt to the West is now \$20 billion. In 1979 (according to a CIA report) 85% of every new dollar borrowed by the Poles went into servicing its debt!

Are Americans worried? Ponder this: the two most recommended combat and home defense rifles are the Heckler & Koch 91 and the Springfield M1A. Delivery on the first is 9 months, delivery on the second is one year!

GOLD: More than anything else, gold mirrors the path of inflation and the move to "tangible assets" that has characterized the last dozen years. The great primary bull market in gold began around 1969-70. The first (psychological) phase of a bull market is the phase in which the real investors buy. This is the phase that took gold from 35 to 193, and this movement is shown as wave No. 1 on the monthly chart.



A correction then took gold to the 103 low of August, 1976. From here the second phase of the gold bull market began. The second phase of any bull market is the one in which the public becomes interested, but only a bit interested. This is the phase wherein obvious developments take place, and in gold the obvious development was inflation and a steady rise (against all the US Government's manipulations in the yellow metal).

The always-tricky correction of the second phase is shown on the chart as the decline from No. 3 (850) to No. 4 (474). At point 4 I stated that it was my opinion that the second phase correction was over, and that gold was moving into its third and final phase. The third phase of a bull market is the one in which the public finally comes in "with both feet." I think we will see this occur, but it will occur in its own good time. My own guess is that gold will probably have to go over 850 and perhaps over 1000 before the public comes in "big." And the longer the current base, the greater the ultimate move. By the way, I think it is a point of strength for gold that it dipped only temporarily back into the channel (at no. 4) and is now pushing out above the channel again. This is the formula for a potential upward explosion.

How can one participate in the developing third phase of the gold bull market. In my opinion, one of the most interesting and most profitable ways will be with the Canadian "cheapies." These are low-priced (and in many cases, developing) mines which are listed on the Vancouver and Toronto exchanges. Rather than mindlessly listing two dozen of these companies, I suggest that you write to T.E.Slanker Co. at 610 SW Alder St., Portland, OR 97205.

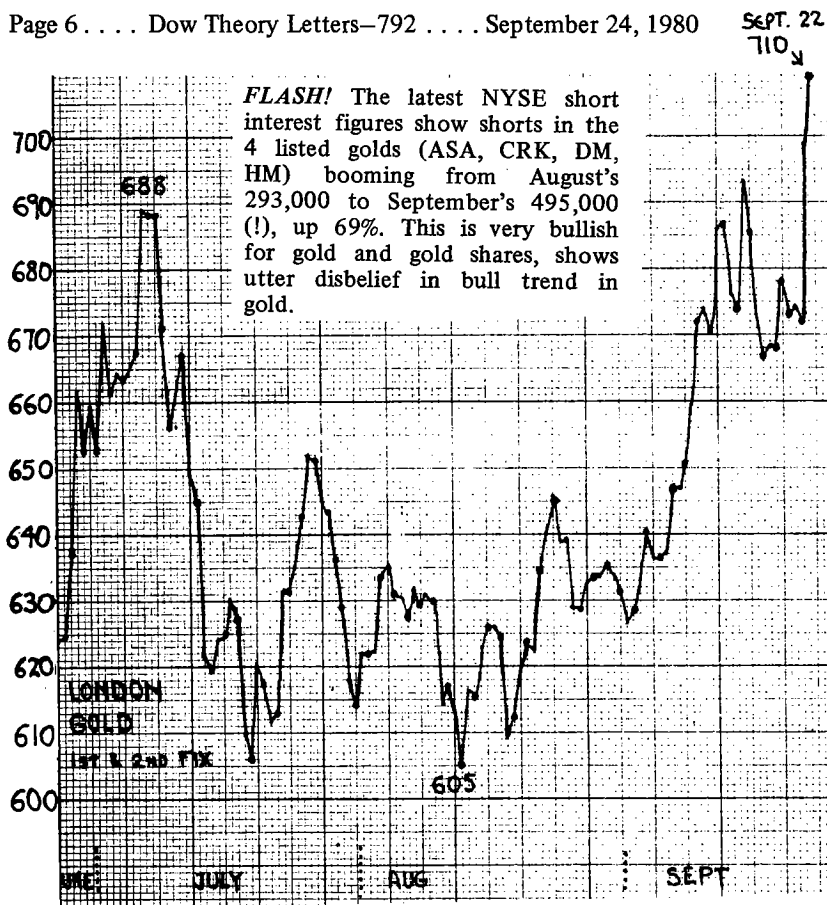
This outfit does some of the best work I have seen on the N. American golds. Their work is well worth receiving and studying.

I want again to suggest that the funds are an excellent way to participate in the third phase of the gold bull market. United Services Gold Fund is a no-load at Box 29467, San Antonio, Texas 78229 (800-531-5777). Then you have the excellent load-fund, International Investors at 122 E. 42nd St., NYC 10017 (most brokers can buy this one for you).

Of course, the basic and most fundamental way to participate in gold is with gold, and I mean gold coins. I personally like the new Maple Leafs of Canada (one ounce of pure gold) or the old standby, the Krugerrand. Buy 'em and put 'em away in your safe deposit box. "There's no fever like gold fever," and the temperature is just moving towards 100.

Please turn to the daily chart (Page 6) of gold. Both the AM and the PM London fixes are shown on this chart. As I see it, the base has been building with the recent low of 605 standing as the bottom of a 3-month base of accumulation. Let gold back and fill; the longer it fluctuates in this area the better. A rally above 700 should set the stage for an attack on the 1980 high of 850. But as I've said so often, the market's are not for the impatient. I believe gold is going to go through 850 — but it will do so on its own good time.

LATE NOTES: For those who watch the PTI carefully (and more and more subscribers do), I include this chart of the 3 moving averages of the PTI. As you can see, the position of the MA's is bullish with the 3-week MA over 1300 and rising, and the 8-week MA above the 21-week MA and both rising. The



up within its rising channel since June. Last week it broke above the rising channel. As long as this kind of action continues, the pressure will be to a higher stock market. The upward pressure on Wall Street will continue until the PTI turns down on a trend basis. Nothing like that has occurred yet.

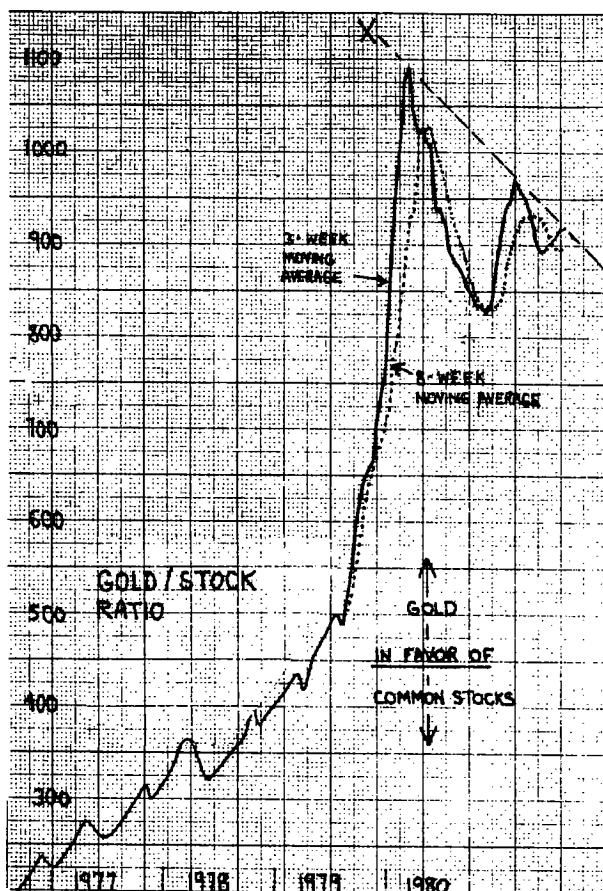
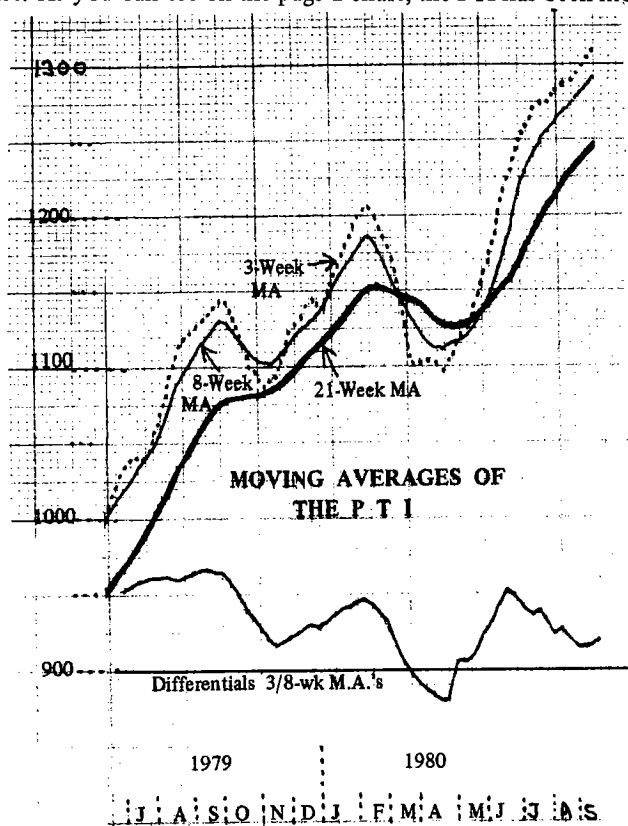
GOLD-STOCK RATIO: This chart shows the *ratio* of the NYSE stock composite divided by gold. Since January common stocks have been stronger than gold (except for a brief period during May and June). Trendline X on the chart delineates the period during which the ratios have been in a downtrend (during this time common stocks were acting relatively stronger than bullion).

Now the 3-week MA of the ratio is pressing against the declining trendline. This suggests a breakout above the declining trendline—in favor of gold. If this occurs, my guess is that BOTH stock and gold will be rising, and in that case we will have a real flight from the dollar.

Conclusion: I think investors (and survivors) must have a participation in both stocks and gold (plus gold shares) at this time. My PTI confirms this as do my gold studies. If you haven't moved yet, read this Letter over and over until you do move. With commodities, gold, stocks now moving up strongly, it occurs to me that we could be on the edge of an explosive, all-out buying panic. I feel that we are moving nearer and nearer to some kind of huge emotional response to inflation.

differential between the 3 and the 8-week MA (bottom of the chart) may now have bottomed out (as it turned slightly higher last week). It is a point of strength for the PTI that the differential did not touch zero in its mild corrective move since June.

The PTI measures the underlying technical strength of the market. As you can see on the page 2 chart, the PTI has been moving



NEXT MAILING: October 8th